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January 28, 1993

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Hand Delivered

Ms. Donna Searcy, Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Re: Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, MM Docket No. 92-266

Dear Ms. Searcy:

Yesterday, NCTA filed an original and five copies of its Comments in the above-captioned proceeding. The copies filed yesterday included several errors in page formatting, resulting in blank spaces on several pages. Also, Section V.F. of the comments erroneously followed rather than preceded Section VI.

Enclosed for filing with the Commission are 12 additional copies of NCTA's Comments, in which those errors have been corrected. No changes have been made to the text of the Comments. NCTA respectfully requests that these copies replace the copies filed yesterday in the file for this proceeding.

Thank you very much. If there are any questions concerning this matter, please contact the undersigned.

Very truly yours,

Michael S. Schooler/ss

Michael S. Schooler

MSS:tkb

Enclosures

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Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
	)	
Rate Regulation	)	

COMMENTS OF
THE NATIONAL CABLE TELEVISION ASSOCIATION, INC.

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January 27, 1993

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ATTACHMENT

B. Owen, M. Baumann and H. Furchtgott-Roth, Cable Rate Regulation: A Multi-Stage Benchmark Approach (1993)

SUMMARY

Congressional Intent

- The legislative history of the 1992 Cable Act makes it clear that Congress had two key purposes with regard to regulation of cable rates:

  1. To provide a modestly-priced, tightly-regulated basic tier of service that would include local broadcast and cable "PEG" (public, educational, and governmental) channels.

     - Many cable operators have recently created these tiers, if they did not previously exist, in order to comply with the law.

  2. To rein in "renegades" -- that minority of cable operators who have charged unreasonable rates for expanded services (those including cable program networks).

- Given that intent, Congress established different regulatory standards for basic and expanded services.

Regulatory Standards Specified by 1992 Cable Act

- Basic service:

  - The FCC will develop rules governing the rates cable systems not subject to effective competition may charge for basic service, with objective of keeping those rates no higher than if the systems were subject to effective competition.

- Expanded service:

  - The FCC will develop criteria by which it will review, on a case-by-case basis, complaints that rates for expanded service are unreasonable, in comparison to rates of all systems.

- Equipment:

  - The FCC will develop guidelines to regulate rates for the installation and lease of equipment, including remote controls and converters, that is used to receive basic service.

- Premium services:

  - Services offered on a per-channel or per-program basis will not be subject to regulation.

Regulation of Basic Service

- o The FCC should establish "benchmarks" for rates for basic service.
  - These benchmarks would be based upon comparisons of rates found in systems subject to "effective competition".
    - o This would ensure that rates are comparable to those that would be found in a competitive environment.
  - These benchmarks would factor in the number of channels available on a system.
    - o This will help account for the variation in the cost and sophistication of a different cable systems.
  - The range of per-channel rates for basic service in competitive systems would form the zone of reasonable rates for regulated systems.
- o Systems whose rates exceed these benchmarks would have the opportunity to justify the rates to local authorities.
  - In extreme cases, local jurisdictions could resort to rate-of-return hearings.
- o Cable systems would be permitted to "pass through" the following costs into rates:
  - Franchise fees and taxes
  - New PEG access costs
  - Retransmission fees paid to broadcasters
- o Benchmarks would be adjusted annually based upon the changes to rates in competitive systems.
- o Systems would be permitted to raise their rates to the benchmark in any given year. If the Commission required increases to be phased in, systems would be permitted to pass through costs for new program services and rate increases for existing program services, up to the benchmark level.

Regulation of Expanded Service

- o The FCC should establish an "unreasonableness" standard for expanded tiers of service by examining the rates for all systems.

- The FCC would, again, establish benchmarks by evaluating revenues from all regulated services and equipment.

- These benchmarks would factor in the number of channels available on the system.

o Systems that fall below the 95th percentile for all systems, as proposed by the Commission, would be deemed to have reasonable rates. Rates of systems above the 95th percentile would be tentatively presumed to be unreasonable.

o Again, systems with rates presumed "unreasonable" could rebut the presumption with cost-of-service evidence.

o Benchmarks would be adjusted annually based on surveys to determine percentage changes in the median industry rates.

- The same percentage change would be made in the benchmarks.

o Systems below the benchmark could independently enact annual rate increases.

Regulation of Equipment

o Rates charged to basic subscribers for installation, additional outlets, and equipment would be regulated on the basis of direct costs, plus overhead, and a reasonable profit.

o Rates for these items would be evaluated as a whole, rather than on an item-by-item basis.

- This approach will allow cable operators to provide below-cost, promotional offerings (of installation, for example) that are designed to increase subscribership, and thereby reach economies of scale that lower per-customer costs.

Procedures for Implementing Basic Service Regulation

o Where a franchising authority chooses not to seek certification from the Commission, basic rates cannot be regulated.

o A finding that effective competition does not exist in a franchise area is a prerequisite to assumption of rate regulatory authority. Until the Commission, after an opportunity for comment by the operator, finds an absence of effective competition, a cable operator's rates are not subject to regulation.

- Franchising authorities should be required to submit sufficient information on their request for certification for the Commission to meaningfully determine:
  - whether effective competition is present or absent;
  - whether the franchising authority has authority to regulate rates;
  - whether the franchising authority has adequate regulations, procedures and personnel to be qualified to regulate rates.
- Franchising authorities should have 30 days in which to rule on an operator's request for an increase in basic tier rates. If a franchising authority fails to reach a determination within that time period, the increase would automatically go into effect, subject to the authority's ability to order a rollback.

Complaint Procedures for Non-Basic Rates

- In order to avoid overwhelming operators and the Commission with non-meritorious complaints, subscribers filing complaints about non-basic rates must make a threshold showing that the non-basic rate exceeds the benchmark.
- Operators would have the right to demonstrate that rates in excess of the benchmark are justified.
- Complaints about proposed rate increases must be filed within 30 days of receiving notice of the proposed increase.
- The Commission does not have the authority to order refunds for rates in effect prior to the effective date of its regulations.

Uniform Rate Structure

- The Act allows operators to establish reasonable categories of service with separate rates and terms, so long as these are uniformly applied throughout a franchise area.

Negative Options

- The prohibition on negative option billing does not apply to changes in the composition of tiers or system-wide equipment modifications; it would only apply where a subscriber has an option whether to take a particular service, tier or item of equipment and does not already take that service.
- Retiering to comply with the new rules would not be a negative option prohibited under the Act, or a prohibited "evasion".

Leased Access

- Rates for leased access channels must be based not simply on the operator's costs of providing the leased access channel but also on the effects of the channel on the operator's own program packages and offerings. Operators should not be required to provide leased access channels at a rate that is lower than the highest implicit leased access charge "paid" by any programmer on its system.

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COMMENTS OF
THE NATIONAL CABLE TELEVISION ASSOCIATION, INC.

The National Cable Television Association, Inc. ("NCTA"), by its attorneys, hereby submits its comments in the above-captioned proceeding. NCTA is the principal trade association of the cable television industry, representing cable television system owners and operators and cable program networks. NCTA's members also include equipment suppliers and others interested in or affiliated with the cable industry.

INTRODUCTION

Of all the numerous rulemaking proceedings set in motion by the Cable Television Consumer Protection and Competition Act of 1992 (the "Act"), none is of more critical importance to the needs, interests and concerns of consumers than this one. The rates charged by cable operators to their subscribers determine the extent to which operators can invest in the programming and technology that has made cable television the principal means by which consumers receive video programming today. If regulation

of rates prevents operators from investing in more or better programming and from maintaining and improving their facilities and technology, consumers will be worse off.

Implementing the Act's requirements and objectives with respect to rates for basic service, non-basic service tiers and equipment used for basic service therefore requires a carefully balanced approach. The Act establishes different frameworks and standards for regulating rates for basic service and rates for optional tiers of programming services, reflecting different policy concerns and objectives. We support the Commission's conclusion that, in general, a benchmark approach is preferable to a cost-of-service approach with respect to both basic and optional tiers of programming -- so long as there are adequate safeguards to assure a reasonable return on investment. But the appropriate methods of calculating and applying benchmarks for basic and non-basic rates must take into account Congress' different regulatory concerns.

Congress established the most pervasive regulatory scheme with respect to basic service -- the tier that includes local broadcast signals. Where cable systems are not subject to "effective competition," the Act authorizes local franchising authorities to ensure "reasonable" rates for basic service pursuant to formulas and standards established by the Commission. To ensure that a low-priced tier is available even to subscribers who desire, primarily, an antenna service to receive broadcast programming, a system's basic rates are not to exceed the rates

that would be charged if it were subject to effective competition.

With respect to tiers of program services other than the basic tier, Congress provided a check on "unreasonable" rate increases but did not subject such tiers to active rate regulation. Rather, the Act provides a case-by-case complaint process at the Commission to deal with the minority of cable operators that Congress believed had abused their market power and whose rates for non-basic tiers were far above what most operators charged.

There continues to be no regulation at all of service offered on a per-channel or per-program basis. Congress and the Commission have recognized that these services operate in a highly competitive marketplace and that their rates are constrained by video rental stores, movie theatres, sporting events, live concerts and other comparable sources of entertainment.

Congress was clearly troubled by the rate increases that followed its deregulation of cable rates in 1984, but not because rates were in all cases -- or even in a majority of cases -- abusive or unjustified. Indeed, in many respects, those rate increases confirmed the assumptions that underlay the Cable Communications Policy Act of 1984 -- that local regulators had been suppressing rates to levels that prevented operators from providing the higher quality of service that consumers wanted and were willing to pay for. As rates increased, expenditures on

programming and technology increased --and, most significantly, so did cable penetration.

Given the choice, consumers clearly preferred the improved service, even at higher rates, to the service that operators were able to provide at lower, regulated rates, since the number of cable subscribers continued to increase. Conversely, if reregulating cable rates were now to stem the investments and reverse the improvements in programming and technology, consumer satisfaction (and cable penetration) would presumably be diminished, even though subscribers were paying less than might, in a deregulated environment, be the case.

Still even though the increases in cable rates were accompanied by precisely the beneficial effects that Congress had hoped for in 1984, there was some concern that not all the increases in rates resulted in improved service and that not all the effects of rate deregulation were benign. In acting to reregulate rates, Congress was persuaded that in some cases, cable operators had raised their rates considerably beyond what was necessary to meet consumer demand with improved service and had, indeed, taken an opportunity to reap excessive profits. These operators were, in Congress's view, the exception and not the norm. Thus, the Committee on Energy and Commerce of the House of Representatives found

> that rate increases imposed by <u>some</u> cable operators were not justified economically and that a <u>minority</u> of cable operators have abused their deregulated status and their market power and have

> unreasonably raised the rates they charge subscribers.[1/]

It was, in part, to restrain the unreasonable actions of these "'renegades' in the cable industry"[2/] that Congress acted. The case-by-case complaint procedure at the Commission for dealing with unreasonable rates for non-basic tiers reflects this policy concern.

But concern over increasing rates was not limited to that minority of cases where the increases were viewed as excessive and unreasonable. Even in the majority of instances where rate increases were wholly justifiable and reflected legitimate cost increases, concern existed that cable was becoming simply too expensive for some consumers who had come to depend upon it as their principal means of obtaining broadcast television programming. As more and more satellite-delivered program networks were added to systems and the price and quality of existing networks continued to increase, even a fully competitive price for a package that included all these networks along with retransmitted broadcast signals, access channels and the cable operator's own locally originated channels might have made cable, for some consumers, an unaffordable luxury. Thus, Congress acted not only to rein in the "renegades" who were charging excessive

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1/ Report of the Committee on Energy and Commerce on the Cable Television and Consumer Protection Act of 1992, H.R. Rep. No. 92-628, 102d Cong., 2d Sess. 33 (1992) ("House Report") (emphasis added).

2/ Id. at 30.

rates but also to ensure that, while most subscribers might opt to purchase the entire package of broadcast and satellite services made available by a cable system, a lower-priced, less inclusive "basic" service would also be available. The responsibility of franchising authorities and the Commission to ensure that these basic rates are constrained to a competitive level reflects this policy determination.[3/]

Finally, Congress sought to ensure that the provision of equipment and related services to basic service subscribers was not itself a source of excess, supracompetitive profits for cable operators. In some cases, cable operators provide remote control devices and other equipment to subscribers at a monthly rate that requires the subscriber, ultimately, to pay more than an amount that would cover the operator's costs plus a reasonable profit. It is not quite right, however, to view such charges as generally providing monopoly profits to the cable operator. Indeed, if, as Congress assumed, cable operators were typically not subject to effective competition, they would have no need to charge excessive rates for equipment in order to recover the full value of this supposed monopoly.

3/ "Subsection (b) directs the FCC ... to promulgate regulations that will govern the provision of a low priced tier of programming, which includes all broadcast signals and other programming of interest to cable subscribers." Id. at 81-82 (emphasis added).

But what a cable operator is able to do, when it includes some of the cost of providing cable service into the price of equipment and additional outlets, is to reduce the price of basic service itself. In effect, subscribers who purchase only basic service, with no remotes, additional outlets or other optional equipment, have paid a rate that is lower on account of those subscribers who are willing to pay more for a package of cable service that includes additional equipment and outlets. In the end, these pricing policies may, by providing a lower-cost basic service option, make cable service available to more subscribers. Conversely, requiring cable operators to load all of the costs of providing basic service into basic service rates and to reduce their charges for remote control equipment and additional outlets would raise the lowest available price for cable service and reduce the total number of subscribers -- a result that Congress did not desire or intend.

The Act requires that, in establishing standards for regulating basic service rates, the Commission must ensure that the charges attributable to equipment, installation and additional outlets be based on the actual cost of those service components. But this need not, as we will show, require a regulatory approach that prevents operators from charging rates for equipment and additional outlets that, to some extent, reduce the price for installation and for basic service so as to maximize subscribership.

To implement the Act's different requirements with respect to rates for basic service, non-basic service tiers, and equipment used for basic service in a way that promotes rather than stymies the continued growth and improvement of cable service and that does not unconstitutionally prevent cable operators from earning a fair return on their investment requires an approach that keeps Congress's different objectives in mind. Such an approach, as the Commission appears to recognize, requires a separate analysis of how best to establish reasonable rates for basic service and how best to rein in the "renegades" in the provision of non-basic tiers.

I. STANDARDS FOR REGULATING RATES FOR BASIC SERVICE

The Act requires cable operators to provide a separately available basic service tier, which subscribers must purchase before they can buy any other tier of service.[4/] This tier must include all broadcast signals carried by the system except for those that are retransmitted to systems by satellite carriers, and it must include any public, educational or governmental access programming that is required by the system's franchise to be provided to subscribers. Cable operators may choose to

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4/ Section 623(b)(7)(A). Cable operators may also -- but are not required to -- make the purchase of basic service a prerequisite to the purchase of video programming offered on a per channel or per program basis. Id., Section 623(b)(8)(A).

provide any other services along with these mandatory components of basic service.

Where a cable system is not subject to "effective competition," as that term is defined by the Act, local franchising authorities are permitted to regulate the system's rates for basic service, provided that they have legal authority and adequate personnel to do so -- and provided that they regulate in accordance with the procedural and substantive regulations promulgated by the Commission. Those regulations are to include "formulas or other mechanisms and procedures"[5/] that "ensure that the rates for the basic tier are reasonable."[6/] Specifically, the Commission's regulations are to be

> designed to achieve the goal of protecting subscribers of any cable system that is not subject to effective competition from rates for the basic service tier that exceed the rates that would be charged for the basic service tier if such cable system were subject to effective competition.[7/]

The Act also enumerates several factors that the Commission is to "take into account," in establishing regulations that ensure such competitive rates. Those factors include (i) the rates for systems subject to effective competition; (ii) the direct costs incurred by operators in obtaining and transmitting services carried on the basic tier (and any changes in such

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5/ Id., Section 623(b)(2)(B).

6/ Id., Section 623(b)(1) (emphasis added).

7/ Id. (emphasis added).

costs); (iii) a reasonably allocated portion of the joint and common costs of providing cable service to subscribers; (iv) any revenues that might be obtained from advertising carried on the basic tier; (v) a reasonably allocated portion of any franchise fees, taxes and other governmental charges and assessments imposed on cable operators; (vi) any amounts paid by operators to satisfy access channel obligations and other service obligations imposed by the franchise; and (vii) a reasonable profit for the operator.[8/]

The Commission proposes to adopt regulations based on a "benchmark" approach, and to reject cost-of-service ratemaking as the methodology for ensuring reasonable rates. We believe that a benchmark method is the right approach to implementing the Act's requirements and objectives. But establishing benchmarks that accurately reflect competitive rates -- and determining how to adjust those benchmarks to account for changing costs and conditions -- requires careful analysis. If benchmarks were set too high and there truly were no effective competition, consumers would pay too much for basic services. On the other hand, if benchmarks were set too low, cable systems, which depend on a steady and predictable cash flow to pay for quality programming and to maintain, improve and extend their physical plant, could be quickly and severely damaged.

8/ See id., Section 623((b)(2)(c).

Any regulation of cable rates that affected the quality and level of service provided to subscribers would go beyond the statutory objective of ensuring competitive rates and, in any event, would raise serious First and Fifth Amendment problems.[9/] Therefore, a benchmark approach must, in the first instance, establish benchmark rates that are likely, in almost all cases, to cover the costs -- plus a reasonable profit -- of any service that the operator might choose to provide, and any facilities that might be used to provide such services. Such an approach must also include an appropriate method of adjusting those benchmarks over time. And it must include procedures and standards that allow a system to increase its rates beyond benchmark levels where benchmark rates are demonstrably insufficient to enable the system to recover its costs plus a reasonable profit.

A. Benchmarking Is the Right Approach

The Commission's tentative conclusion that it "should not select cost-of-service regulation as the primary mode of regulation of cable service rates"[10/] is the right one. In theory, cost-of-service regulation is supposed to ensure that rates are sufficient to cover but not exceed the regulated company's costs plus a reasonable profit. In an industry where

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9/ See, e.g., Riley v. Nat'l Federation of the Blind of N.C., 487 U.S. 781 (1988).

10/ Notice, para. 2.

costs are not standardized and vary significantly from system to system, any generally applicable benchmark is virtually certain to err on one side or the other -- the benchmark will either permit rates that either exceed or prevent the recovery of costs plus a reasonable profit in any particular case. Cost-of-service regulation theoretically enables regulators to set rates at precisely the right level in each particular case.

In practice, of course, this is not the case. Identifying actual costs of providing service, as the Commission has found in other contexts, is no simple matter. To do so generally requires the development and imposition of uniform accounting methods, which may themselves fail to measure accurately the true costs and profits in each particular case.[11/] It also requires lengthy, complex and burdensome proceedings, which, wholly apart from the accuracy of their results, impose significant costs and intolerable delays on regulated companies, as well as substantial costs on the regulators. And, most importantly, it requires regulatory authorities that have the resources and expertise to implement cost-of-service regulation in a competent manner.

11/ The Commission recognized, in the course of developing the revised Uniform System of Accounts for telephone companies, that a revised system might reduce, but certainly would not eliminate, the need for costly and complex special studies to measure costs in particular cases. See Revision of The Uniform System of Accounts and Financial Reporting Requirements, 60 R.R.2d 1111 (1986).

Moreover, cost-of-service regulation creates undesirable incentives. Under cost-of-service regulation, regulated companies may have no incentive to operate in the most efficient manner. To the contrary, where the rate of return exceeds the cost of capital, they will have an incentive to add to their costs, since increasing their "rate base" will allow them to increase their rates and their profits.

These problems have led the Commission to question the utility of cost-of-service regulation, even where it has traditionally been applied by experienced regulators.[12/] They make cost-of-service regulation particularly unsuitable in the context of cable television rate regulation. Apart from the expenses of cost-of-service regulation, the delays and uncertainties would severely affect the availability of financing for future investment in programming and facilities -- and could seriously disrupt payment of existing loan obligations. Moreover, there is, in the cable industry, no existing uniform system of accounting. As the Commission has learned, developing such a system is a task measured in years or decades -- certainly not one that can be completed in time for implementation of the Act's rate regulation provision. [13/]

12/ See e.g., Policy and Rules Concerning Rates for Dominant Carriers, 4 FCC Rcd 2873 (1989).

13/ The Commission began its proceeding to revise the Uniform System of Accounts for telephone companies in 1978 and issued its Report and Order eight years later. See Policy and Rules Concerning Rates for Dominant Carriers, supra.

Finally, the Act assigns principal responsibility for basic rate regulation to local franchising authorities, whose resources, expertise and competence to apply cost-of-service regulation are likely, in most if not all cases, to be non-existent.

For all these reasons, Congress made clear that traditional cost-of-service rate regulation was far from what it intended for the Commission to require:

> The Committee intends that the Commission establish a formula that is not cumbersome for the cable operator to implement nor for the relevant authorities to enforce. The Committee is concerned that several of the terms used in this section are similar to those used in the regulation of telephone common carriers. It is not the Committee's intention to replicate Title II regulation. The FCC should create a formula that is uncomplicated to implement, administer and enforce, and should avoid creating a cable equivalent of a common carrier cost allocation manual.[14/]

And, for all these reasons, the Commission has properly considered that some form of benchmarking would be a far superior approach -- so long as cost-of-service principles are, in some manner, available to cable operators to rebut the presumptive unreasonableness of rates that exceed applicable benchmarks. Crafting a benchmark approach that meets the requirements and objectives of the Act is a difficult task. But, unlike the implementation of cost-of-service regulations, the task of

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14/ House Report at 83.

designing and implementing appropriate benchmarks is one that can be achieved.

B. How Are Benchmark Rates To Be Established?[15/]

The Commission has aptly described the essence of benchmarking as a rate regulation technique:

> By a benchmark rate we mean a price against which a given cable system's basic tier rate would be compared. The system's rate would be presumed reasonable if it did not exceed the benchmark. Under a benchmarking approach to rate regulation, the Commission would establish a benchmark rate, or a simple formula which could be used to derive such a rate. Cable systems with rates exceeding the benchmark price by a significant amount as determined by the Commission would be required to reduce their rates to the benchmark level unless the system could justify a rate higher than the benchmark.[16/]

But how are the benchmark standards to be derived? The Commission's task, according to the Act, is to keep a system's basic rates at levels that approximate those that would be charged if the system were subject to "effective competition." The Commission has identified several possible indices of competitive rates, each of which present some problems.

15/ A more technical discussion of how an appropriate benchmark approach might be crafted, both for application to basic rates by franchising authorities and for resolving complaints of "unreasonable" rates for non-basic cable programming services, can be found in the attached economic analysis from Economists Incorporated. See B. Owen, M. Baumann and H. Furchtgott-Roth, Cable Rate Regulation: A Multi-Stage Benchmark Approach (1993).

16/ Notice, para. 34.